IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

In the Matter of IRVING WHITEHOUSE COMPANY,
Bankrupt,

L. C. REAM, HAZEL MOWERS, MABEL CONNOR, H. E. WOODLAND, MAUDE MOWERS, OSCAR LANTOR, CHARLES THEIS, ALEXANDER STEPHENS, O. W. WITTMER, T. S. LANE, DAVID ACKERMAN, STANLEY HODGMAN, and AUGUSTA W. HOWELL,
Appellants,

vs.

W. S. McCREA, Trustee of IRVING WHITEHOUSE COMPANY, Bankrupt,
Respondent.

No. 4075

On Appeal and Petition to revise, from the United States District Court, Eastern District of Washington, Northern Division.

RESPONDENT'S BRIEF.

R. J. DANSON,
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STATEMENT.

Each of the claimants severally filed with the Referee in Bankruptcy a petition for an order directing the Trustee to deliver to such petitioner certain securities which it was alleged, were in the Trustee's possession, or in the event the securities could not be delivered, due to a sale having been made, for an order requiring the Trustee to pay to the several petitioners the amount realized from any such securities so sold. None of the securities in question ever came into the hands of the Trustee, but from the stipulated facts it appears that some securities, similar to those claimed by petitioners, were, on August 3, 1921, in the possession of E. F. Hutton & Company, of New York, the correspondent broker for the Bankrupt. On August 3, 1921, a Receiver was appointed over the Bankrupt, by the Superior Court of Spokane County, Washington. At the time the Receiver was appointed, the Bankrupt had with Hutton & Company securities which were soon thereafter sold for $48,155.28. These securities were regularly held by Hutton & Company as collateral to secure an indebtedness due from the Bankrupt to it of $37,690.01. Immediately after the Receiver was appointed he ordered Hutton & Company to sell the securities, which was done, the amount realized therefrom being $48,155.28, or $10,465.27 in excess of the indebtedness due Hutton & Company, and it is over this remainder that this contest is waged. It was stipulated that Hutton & Company, at the time the sales of the several securities were made, imme-

diately passed the amount received toward the liquidation of the indebtedness due it from the Bankrupt and that the amount received from the remainder of the securities, after its debt was paid, was remitted to the Receiver.

On November 7, 1921, a petition in bankruptcy was filed against said Irving Whitehouse Company, and on December ...., 1921, an adjudication in bankruptcy was made, and on January ...., 1922, Respondent was elected Trustee for said Bankrupt. Some time later the Receiver, appointed by the State Court, turned over to Respondent the money and property remaining in such Receiver's hands, and appellants seek through this proceeding to secure the entire $10,465.27 so transmitted by Hutton & Company to the Receiver, and which they claim finally came into the hands of Respondent.

The securities, which were so held by Hutton & Company as collateral to its debt of $37,690.01, and which were sold, were so sold on the dates and for the amounts as follows (Tr. ....):

1921			Dr.	Cr.
Aug. 3		Amount due from Bankrupt	$37,690.01	
Aug. 5		International Nickel..	10.14	$ 1,384.00
	(X)	Loews Theatre..........	10.23	1,156.00
		International Nickel..	10.24	2,718.00
		International Nickel..	10.53	342.85
		Willys Overland........	10.53	654.00
	(X)	New Cornelia............	10.55	400.42
		Canada Copper..........	10.56	341.00
		Canada Copper..........	10.56	292.00

	Canada Copper	10.56	8.16
(X)	Middle States Oil	11.00	573.55
	General Electric	11.00	1,290.41
	Cerro De Pasco	11.00	488.02
	General Asphalt	11.00	2,659.25
	Midvale Steel	11.00	147.38
	Midwest (or Standard Oil of Ind.)	11.04	3,094.96
	Denny Oil	11.06	10.96
	Denny Oil	11.06	18.92
	Silver King of Arizona	11.08	.96
	Anglo American Oil	11.10	44.71
	Mexican Petroleum	11.27	1,055.61
	Kennicott Copper	11.27	424.01
	Missouri Pacific Pfd.	11.27	1,198.05
(X)	Northern Pacific Ry.	11.27	2,296.80
(X)	U. S. Rubber	11.27	725.34
	Pacific Oil	11.27	143.84
	General Motor	11.27	301.80
	Invincible Oil	11.27	175.73
	American Can	11.27	263.10
	American Sugar	11.27	1,849.68
	Cuban American Sugar	11.27	241.42
	Chili Copper	11.27	344.39
	Great Northern Ore.	11.27	277.25
	Sears Roebuck Scrip	11.36	586.50
	Studebaker	11.47	337.34
	Willys Overland	11.47	282.26
	St. Paul Pfd	11.47	414.35
	Central Leather	11.47	658.70
(X)	Middle States Oil	11.53	27.05
	Columbia Graphaphone	12.03	46.69
	Transcontinental Oil	12.11	375.50
	Allis Chalmers	12.11	623.70
(X)	Chili 6's	12.16	737.17
(X)	St. Paul 4's	12.16	769.69
	Sears Roebuck	12.27	974.03
	Pennsylvania Pete B	12.28	208.88
	U. S. Food	12.28	254.03

	United Pacific	12.28	119.46
	China Copper	12.29	382.04
	Greene Cananea	12.41	413.70
	General Motor	12.42	636.85
	Pennsylvania Ry	12.49	367.05
	Pierce Arrow	12.49	139.35
	Royal Dutch	12.49	762.63
	Chesapeake & Ohio	12.49	556.85
	Can American Pete B	1.02	3.04
	General Electric	1.02	1.28
	Pullman Company	1.18	754.48
	Retail Stores	1.50	132.94
(X)	Pure Oil	1.51	655.35
	Westinghouse Electric	1.55	479.36
(X)	Chicago Rock Island	1.55	681.17
	Pullman Company	2.06	1,582.02
	To Balance	$ 1,196.01	
		38,886.02	38,886.02
	Balance brot. down		1,196.01
	Pure Oil	2.12	9.16
	Sullivan	2.27	612.15
	Montana Power	2.39	891.20
(X)	American Hide & Leather	2.40	760.28
	Southern Ry	2.43	196.85
	St. Paul Com	2.50	404.03
Aug. 5	Swift & Co		2,250.09
	Texas		.29
	Standard Oil of N. J. Com.		677.25
Aug. 6	American Beet Sugar	10.21	146.93
(X)	International Tel. Sales & Eng. 6-1924	11.16	1,519.32
	Certainteed Products	11.54	539.00
Aug. 8	Commerce, American Ship &	2.52	99.52
Aug. 9	United Smelting Pfd.	10.30	183.18

Aug.	9	Libby	11.39	24.98
Aug.	9	Sullivan	12.43	418.10
Aug.	16	Standard Oil of	10.19	536.93
		To Balance Account		$10,465.27

In order to illustrate the situation better we have re-arranged the securities in the order of the date of the sales. The securities claimed by claimant are indicated thus: (X).

It is respondent's contention that none of the securities in which appellants were interested survived, and that in any event, they were entitled to no relief in excess of that granted by the order of the District Court. This order allowed claimants the value of the security of the same kind held by Hutton & Company on August 3, 1921, after deducting therefrom the pro rata part of the indebtedness due Hutton & Company, for which the security was held as collateral, first applying on this indebtedness the amount realized by Hutton & Company from those securities with Hutton & Company in which no customer was interested, amounting to $1414.00 The theory of the order of the District Court was that while the petition in bankruptcy was not filed until November 7, 1921, yet for the purpose of determining the survival of securities, the condition as it existed at the time of the appointment of the State Court Receiver should be adopted.

It is respondent's further contention that should this court not agree with the order of the District Court, that none of the securities claimed by the claimants survived, with the possible exception of 3-4th's interest in

the American Hide and Leather stock claimed by appellant Charles Theis and the International Telephone Sales and Engineering 6-1924, claimed by T. S. Lane, and that none of claimants outside of Theis and Lane are entitled to any relief under this last theory. The reason why Theis would only be entitled to a 3-4th's interest in the American Hide and Leather stock, is that the Bankrupt should have been holding for said Theis 30 shares of said stock and for one Flagner 10 shares of the stock and Theis could not claim more than his proportion of such stock, or 3-4th's.

These securities which were held by E. F. Hutton & Company, were so held as the property of the Bankrupt. Hutton & Company did not know any of claimants in the transaction, or that they had, or claimed, any interest in such securities. To a large extent they were purchased for the Bankrupt on its order, or were securities which had been deposited with it by the Bankrupt, bearing proper endorsements. None of the securities were in any manner traced by claimants, except to the extent of showing that the Bankrupt should have held for their account a certain amount of such securities, and that the Bankrupt had no similar securities, except those with Hutton & Company.

Some of the claimants prior to August 3, 1921, had paid in full for the securities which they had purchased, and in some cases the debit balance of some of the claimants had been changed into a credit balance, through the conversion and sale by the Bankrupt of certain of the securities in which such claimants were interested.

The situation of claimant was not dissimilar from that of nearly all of the other creditors of the Bankrupt. The Bankrupt, at the time the Receiver was appointed was indebted in the sum of $211,098.27, as the result of purchases made by customers from it of securities, which the Bankrupt was to, and did, purchase for the customer through Hutton & Company, but which securities were converted by the Bankrupt.

> "As the result of these transactions, on the aforesaid date" (August 3, 1921), "Irving Whitehouse Company was indebted to its customers who were dealing in Eastern stocks and bonds through Hutton & Company, either on marginal or cash basis, in the sum of $211,098.27, computed on the basis of what the securities would have been worth on said August 3, 1921." (Tr. ....)
>
> "Most of the said claims, amounting to $211,098.27 were due to the fact that the Bankrupt had been paid the purchase price in certain instances in full for the purchase of the securities through Hutton & Company, which the Bankrupt did not deliver, or that the claimant had ordered on margin to be purchased through Hutton & Company, stocks or other securities and had put up collateral in the way of stocks or bonds with the Bankrupt, which the Bankrupt either sold or deposited with Hutton & Company as collateral for its account and such securities were sold by Hutton & Company and no accounting had with the customer." (Tr. ....)

All of these securities held by Hutton & Company for the Bankrupts on August 3, 1921 as shown above were the property of the customers of the Bankrupt except as follows:

"Of all the securities above listed, Irving Whitehouse Company owned only the following, which sold at the price set below."

15	Royal Dutch	$ 762.63
10	American Can Company	263.10
50	Transcontinental Oil	375.50
333	Canadian Copper	12.77
	Total	$1,414.00

"The rest belonging to customers of Irving Whitehouse Company, by far the greater amount being the property of marginal dealers."

MOTION TO DISMISS APPEAL.

Respondent questions the jurisdiction of the Court and moves that the appeal of the appellants Stanley Hodgman, Mabel Connor and Alexander Stephens be dismissed, for the reason that the amount involved is less than the jurisdictional amount, as provided by Sec. 25a of the Bankruptcy Act.

Appellants seek to have the order made by the District Court reviewed both, by petition to revise, and by appeal. If appeal is the proper remedy, then we take it relief cannot be afforded by a petition to revise. Likewise, if an appeal is the proper remedy, the amount involved must be $500.00 or more.

While the appeal has been taken by all of the appellants jointly, yet there were separate petitions for each of the appellants, and a joint order was made covering the claims of all of the appellants, as a matter of convenience only, and it would seem to be mani-

fest that jurisdiction cannot be conferred through the taking of a joint appeal, where otherwise there would not be the necessary jurisdictional amount.

On the question of whether the proper method for the purpose of obtaining a review is by petition to revise, or an appeal, the Circuit Courts of Appeal are, apparently, hopelessly divided. Thus, in Re Pierson, 233 Fed. (2nd Circuit), 519, it was held in 1916 that the proper remedy was by petition to revise, while the same Court in Re B. Solomon & Co., 268 Fed. 108, in 1920 held that the proper remedy was by appeal. The Supreme Court of the United States, if we constru the decisions properly, holds that the remedy is by appeal.

In the Matter of Loving, 224 U. S. 183 (56 L. Ed. 725);

Coder vs. Arts, 213 U. S. 223 (53 L. Ed. 772);
Hewit vs. Berlin Machine Works, 194 U. S. 296 (48 L. Ed. 986)

BRIEF OF ARGUMENT.

1. Claimants have no superior equity to the fund in controversy, over the other customers of the Bankrupt who owned the remainder of the securities with E. F. Hutton & Company, aggregating in value $46,741.28.

2. There is no distinction between the equities of a marginal and cash dealer.

In re J. C. Wilson & Co., 252 Fed. 631 (649, 650, 651-654);

In re Mason, 282 Fed. (9th Cir.), 202.

3. In cases of this kind, the first essential always is that the claimant shall be able to trace his securities, or the proceeds.

Schuyler vs. Littlefield, 232 U. S. 707 (58 L. Ed. 807);

In re Brown, 193 Fed. (2nd Cir.) 24;

In re J. C. Wilson & Co., 252 Fed. 631 (652);

In re Mason, 282 Fed. (9th Cir.) 202.

4. Claimants could not obtain relief, on the theory of unjust enrichment, since practically all of the creditors of the Bankrupt are in the same position. However, the doctrine of unjust enrichment is not recognized in this circuit.

Spokane County vs. First Nat. Bank, 68 Fed. 979;

Columbia Digger Co. vs. Rector, 215 Fed. 618 (630);

Titlow vs. McCormick, 236 Fed. 209 (214);
U. S. Nat. Bank of Centralia vs. City of Centralia, 240 Fed. 93 (95);

In re Morris Bros. 282 Fed. 670;
In re J. C. Wilson & Co., 252 Fed. 631 (640-642).

5. The only possible theory, for affording any of the claimants, other than Theis and Lane, any relief in this proceeding, is the rule of co-suretyship or joint

adventurers. In re Toole, 274 Fed. (2nd Cir.) 337.

6. Claimants must prevail, if at all, on the strength of their title, and not on the weakness of the title of the Trustee. However, where any customer of the Bankrupt elected to claim as a general creditor for his securities converted, instead of reclaiming the securities, or their proceeds, the title to such securities would become vested in the Trustee for the benefit of the general creditors to be distributed in the way of dividends. Claimants' share can not be increased due to any failure of the other customers to make claim.

> *In re Pierson,* 233 Fed. (2nd Cir.) 519;
>
> *In re Pierson,* 238 Fed. (2nd Cir.) 142;
>
> *In re J. C. Wilson & Co.,* 252 Fed. 631 (639 and 653);
>
> *In re Archer, Harvey & Co.,* 289 Fed. 269.

7. The 1910 amendment to Section 47 of the Bankruptcy Act specifically provides for cases of this kind and the Trustee does not now stand in the shoes of the Bankrupt.

> *Pacific State Bank vs. Coats,* 205 Fed. (9th Cir.) 618.

ARGUMENT.

Briefly stated the situation is this: None of the securities or the proceeds realized therefrom, in which any of the claimants were interested, survived on November 7, 1921, with the possible exception of the pro-

ceeds of certain securities in which claimants Theis and Lane, were interested, unless for the purpose of determining such survival the condition as it existed August 3, 1921, the date when the receiver was appointed, be accepted. Prior to the filing of the petition in bankruptcy, all of these securities, with the exception of the ones in which Theis and Lane were interested, had been rightfully sold by the pledgee, E. F. Hutton & Company, and the proceeds rightfully applied toward the satisfaction of the indebtedness due Hutton & Company, for which said securities stood pledged. If, however, for the purpose of working out some equity in favor of the claimants, other than Theis and Lane, the condition which existed more than three months prior to the filing of the petition in bankruptcy be accepted, we find the following condition: At that time the bankrupt owed its customers, including claimants, $211,098.27, under conditions which created equities in favor of such customers equal to that of claimants, with the exception that as to part of such amount of $211,098.27 no securities of a similar nature to those in which some of the customers were interested still remained with Hutton & Company. However, to the extent of $46,741.28 (the value of the securities with Hutton & Company, less securities to the amount of $1,414 in which the customers were not interested), the customers whose rights arise through the conversion of such securities have in every respect as high an equity as claimants. Assuming that claimants have traced their securities as of date August 3, 1921, then the securities of these other customers have like-

wise been traced, and such securities were owned by such other customers. It follows that at the time the receiver was appointed by the State Court they were customers of the Bankrupt, for whom the Bankrupt should hold, and did hold, securities of the value of $46,741.28, and which securities were in the hands of Hutton & Company properly held as collateral for the indebtedness due from the Bankrupt of $37,690.00. Hutton & Company had the absolute right to hold and sell these securities, so far as necessary for the satisfaction of its debt. When that debt was satisfied there remained securities, or the proceeds, amounting only to $10,465.27. The contention, therefore, of claimants is, that they should receive this fund which remained, to the exclusion of the other customers of the Bankrupt, who owned the remainder of said securities of the value of $46,741.28 held by Hutton & Company. That, due to the fact that such other customers have not made claim for a return of their securities, or the proceeds, appellants should be permitted to take the entire fund. The proposition can not be sustained on any legal principal, and to allow such claim would be most inequitable.

When it came to the knowledge of any of the customers of the Bankrupt that a delivery of their securities could not be made by the Bankrupt they had the right to one of two remedies: (1) to follow the proceeds realized from the securities: (2) to have judgment against the Bankrupt for the value of the securities converted. If they followed and reclaimed the

proceeds realized for their securities the account was balanced. If they chose to hold the Bankrupt for the conversion of their securities, the Bankrupt became their debtor to the extent of the value of such securities, and the securities or their proceeds became the property of the Bankrupt. Adopting the last course would constitute the Bankrupt as an involuntary purchaser of the securities. Since Irving Whitehouse Company is now Bankrupt, the customer who did not seek to reclaim his securities, or their proceeds, but who claims as a general creditor, has no longer a right to reclaim his securities, or the proceeds, but must take as a general creditor through the distribution of the assets of the Bankrupt. Such customer is vitally interested in this controversy since if claimants should prevail, they have not only lost their right to reclaim their securities, or their proceeds, but the very securities, or their proceeds, which they surrendered for the purpose of augmenting the estate of the Bankrupt, expecting to share in such securities, or their proceeds, as a general creditor, will have been taken for the purpose of bestowing same on claimants who at no time had any interest in such securities, or their proceeds. Stated in another way claimants contention, in effect, is that had all these other customers made claim to the securities, in which they were interested, or the proceeds, appellants would only have been entitled to have received the amount realized from the securities in which they were interested, after deducting the pro rata part of the indebtedness to Hutton & Company, properly chargeable against their securities. Neverthe-

less since certain customers did not make claim for their securities, or the proceeds, claimants are entitled to receive that part which otherwise would have gone to such other customers.

The language of Judge Rose in re Archer, Harvey & Company, 289 Fed. (D. C.) 267 and which case is squarely in point on the merits of this case, is peculiarly appropriate.

> "The practical importance of having a fixed and uniform rule in these cases is great. There is more frequent occasion to apply it in New York than anywhere else. There is therefore more than the ordinary reason why a District Court should accept the view taken by the Circuit Court of Appeals of another circuit. Besides, much can be said for the essential fairness of the practice there prevailing. Under it, each claimant gets all to which he is entitled. That something which might otherwise be taken for the exclusive use of a rival claimant actually goes to all the creditors is really to the advantage of the petitioner, in that it increases the fund upon which he will be entitled to go for a dividend for so much of his claim as is unsecured. It is true that he has the right before his securities can be called upon to contribute to the debt for which they were pledged, to require the application to that pledge of everything which belonged to the Bankrupt and which was pledged with the claimants. But, is there not more of theory than substance in the assumption that the unclaimed property must be treated as if it had been the Bankrupts' at bankruptcy merely because another customer in like class with petitioner does not, after bankruptcy, claim what such other was entitled to? There would seem to be nothing to recommend it, except a certain formal logic which it has or seems to have. Moreover, is there any

> reason why the courts should put a premium upon filing preferential claims? When made, they must be respected; but, as a rule, are not the superior rights so asserted almost always the result of accident or chance? In the long run, would not as high a degree of equity be worked out, if all the customers of the bankrupt brokers shared equally in their assets, and that, too, with infinitely less trouble, delay, and expense."

Claimants apparently contend that they have some superior equity, due to the fact that: (1) some of them had paid in full for their securities at the time the receiver was appointed; (2) some on the theory that sufficient of their securities had been converted so as to turn their debit balance into a credit balance; (3) some on the theory that they had requested the Bankrupt to procure and deliver their securities at once. In this, as shown by the stipulated facts, part of which is quoted above, they were not dissimilar to the other customers, except that claimants have made claim for the proceeds of their claimed securities, while the other customers have not.

Nor in fact is there any distinction between the rights of a marginal dealer and a cash dealer in cases of this kind. Both classes are the owners of the securities and entitled to reclaim same. The fact that the marginal dealer owes something on his purchase affects the situation only to the extent, that he is required to pay the balance of the purchase price before he receives his securities.

In re J. C. Wilson & Co., 252 Fed. 631, on page 640

there is discussed the claim of one Rosenthal, who bought his stock and paid for it in cash. The broker failed to deliver, but deposited the stock with its correspondent broker, Harris, Winthrop & Co., as security for and in liquidation of the indebtedness due from the Bankrupt to its correspondent. The contest was over the securities that were in the hands of Harris, Winthrop & Co. at the time the petition in bankruptcy was filed; Rosenthal's securities were sold by Harris, Winthrop & Co., and the proceeds were applied toward the reduction of the indebtedness of the Bankrupt to it. Rosenthal contended that under these facts he was a class "A" claimant and entitled to a preference in the securities and funds remaining with Harris, Winthrop & Co. This contention was rejected and it was held that Rosenthal was but a general creditor. The court says:

> "The principle has been tersely stated in Multnomah County vs. Oregon Nat. Bank (C. C.) 61 Fed. 912, as follows: 'It is settled that a person may follow and reclaim his property, wrongfully appropriated by another, so long as he can find it. If its form has been changed, he may follow the substantial equivalent of his property, in whatever form. The property into which his own has been changed is impressed with a trust in his favor. But the great weight of authority is against any extension of the rule beyond this.'"

Under the contention of appellant here, Rosenthal should have been entitled to have the value of his securities returned to him out of the fund realized from the sale of the other securities, because other property

should have been used, according to his claim, for the purpose of paying the indebtedness from Wilson & Company to Harris, Winthrop & Co., before resorting to the securities of Rosenthal.

Proceeding further in the J. C. Wilson & Co. case, and in dealing with the Goodwin claim, the court more pointedly discusses the differences, if any, between a marginal dealer and a cash dealer. Thus at page 649 it is said:

> "Once the basic propositions of the Bamford Case are accepted, it would be entirely illogical to hold that, in order to place a claimant in class A, the conversion of stock must per se amount to sufficient to wipe out the debit balance, without regard to the state of whole account between the customer and the broker. Such a distinction, however, has been made by the master between, for instance, the Goodwin claim and the Patterson claim in the case at bar. In the Patterson claim the conversion was sufficient per se to wipe out the debit balance, and the master therefore placed Patterson's claim in Class A. But such cannot be the true test, either on principle or from the standpoint of fair and equitable consideration, based on the practical conduct of business of this kind. *The true inquiry should be to ascertain whether, after and as a result of the conversion, the customer would have a credit balance in his favor on the whole account, or a debit balance.* If he would have a credit balance, he could take courses (2) or (3) above mentioned; i. e., either to recover his securities by paying his debit balance or to obtain the net proceeds by ordering the securities sold. *If, on the other hand, as the result of the conversion, there would nevertheless be a net debit balance against the customer; then, if the securities*

were sold, he would still remain the debtor of the broker, or, if he paid his debit balance, he would nevertheless be out of pocket when the broker delivered the securities to him.

Lastly, in this connection, it is urged that margin customers are on a different basis from those who have paid for their securities outright. There is no logical ground for this distinction. The margin customer is the owner of the securities which the broker is carrying for him, and they become his absolutely the moment he pays any amount outstanding against him. The broker, it is true, may not hypothecate the securities of the outright owner, and may hypothecate those of the margin customer; but he has no right to convert to his own use the securities of the margin customer, and when he does so the results follow which are pointed out in Ex parte Bamford. *This rule applies where there is a conversion of any of the securities originally rightfully hypothecated."* (Italics ours.)

At page 650 the court says:

"Second: Where securities are hypothecated without authority, *or though hypothecated with authority, are in part subsequently converted, the securities remaining stand on equal equities,* provided that, as the result of the conversion of securities originally rightfully hypothecated, the restatement of the whole account shows a credit balance in favor of the customer." (Italics ours.)

At pages 651 to 654 the same question is again dealt with, and the added contention that appellant's securities should have been sold last. The court says:

" * * * The master found that English had traced his 100 shares of stock, and awarded to him a lien in class A for $1,561.90. This conclusion of the master was based upon the theory that Eng-

lish had a claim superior to those of the margin traders. In other words, as Wilson owed only 900 shares of this stock to cash customers, and had on hand with Harris 1,940 shares, the master has awarded in full to the cash customers, and it would follow from this holding that margin customers who had traced, under Gorman vs. Littlefield and Duel vs. Hollins, would receive only their pro rata of the remaining shares * * *.

"This view of the master follows a rather ingenious argument, which carries the theory of presumptive restoration to its ultimate limit. The theory now pressed is that it must be presumed that when the stock broker, for his own purposes, was converting Ray Consolidated, he converted those shares belonging to margin customers, because he owed the cash customers the highest duty not to deal wrongfully with their securities. The difficulty with this theory, as I see it, is that it confuses tracing with priority. Preliminarily, it may be stated that, where a claimant has traced by certificate number, or, under Gorman vs. Littlefield, where there is no other claimant for the same kind of stock, such claimant so tracing is entitled to all of that stock represented either by the identical certificate number or by the same kind of stock 'in the box' of the bankrupt, as the case may be. Whether such a claimant shall be then placed in class A or B depends upon the character of the equity of that claimant as developed by the facts * * *.

"At this point it is urged that it must be presumed that he selected the stock of the margin customer for the purpose of converting it, leaving untouched the stock of the cash customer. The difficulty with this theory is that the stockbroker had no more right to convert the stock of a margin customer than he had to convert the stock of a cash customer; * * *. The conclusion of the special master in this regard can be sustained only

by invoking the purest kind of legal fiction * * *. Without discussing in detail the principles laid down in the Gorman and Duel cases, *supra,* the ultimate result is that the claimant must find physically in existence either the precise certificate or a stock in kind, or the earmarked proceeds where there is liquidation, as in the case at bar, and, if there are not enough shares to satisfy the particular group of claimants, then such claimants are entitled to their pro rata * * *.

"*Where claimants have failed to prove their claim to a pro rata* of Ray Consolidated, such failure cannot enlarge the pro rata of those who have traced." (Italics ours.)

This court has cited with approval in re J. C. Wilson, *supra,* in its decision in re Mason, 282 Fed. 202, where it is said:

"In the present case the marginal traders do not appear to have paid for their shares; all stocks were sold to pay the indebtedness to the pledgee, and the marginal stocks more than paid the amounts of such debt. Marginal traders, who may have desired to save themselves any loss, could have paid up the amount due on their purchases and demanded their stock, and thus put themselves in a preferred class, on an equality with those who paid for the stock in full before bankruptcy. Such a position is discussed in re Wilson (D. C.) 252 Fed. 635, and was involved in Hollins' Case, 241 U. S. 523, 36 Sup. Ct. 615, 60 L. Ed. 1143, and generally the rule of decision is that, where stock certificates have been delivered to a broker as security for trades, but without authority to pledge, and where there is no trade pending and the stock has been pledged by the broker, if the loan has been liquidated, and it has not been necessary to sell the stock in order to satisfy the debt for which it was pledged, the customer may

recover. See also in re McIntyre, 181 Fed. 955, 958, 104 C. C. A. 419; In re Graff (D. C.) 117 343."

In cases of this kind the first essential always is that the claimant shall be able to trace his securities, or the proceeds. If he is not able to do this then no relief can be granted and he can claim only as a general creditor, notwithstanding his wrongs may be great. Thus in Schuyler vs. Littlefield, 232 U. S. 707 (58 L. Ed. 807), it is said:

> "Like all other persons similarly situated, they were under the burden of proving their title. If they were unable to carry the burden of identifying the fund as representing the proceeds of their Interborough stock, their claim must fail. If their evidence left the matter of identification in doubt, the doubt must be resolved in favor of the trustee, who represents all of the creditors of Brown & Company, some of whom appear to have suffered in the same way. Like them, the appellants must be remitted to the general fund."

In re Brown, 193 Fed. 24 (2nd Cir.), it is said:

> "As we said in re McIntyre, Grace's Appeal, 185 Fed. 96, 108 C. C. A. 543: 'While the doctrine of following trust funds has been much extended in the modern decisions, there has never been a departure in the federal courts from the principle that there must be some identification of the property sought to be charged with the trust funds'."

In re J. C. Wilson & Co., *supra,* it is said:

> "The logical procedure, it seems to me, is that the first requirement laid upon a claimant is to trace his stock, or its identifiable proceeds. If he fails in that regard, no matter how grievous the wrong, he becomes a general creditor."

The same principle is recognized in this circuit in re Mason, 282 Fed. 202, where it said:

> "Under such circumstances the customer is entitled to the shares or their proceeds when returned to the trustee if the loan has been paid by proceeds of other securities pledged therefor."

Here no money came into the hands of respondent as the result of the sale of any of the securities, to which claim is made, unless it was the securities of Theis and Lane. The most that can be claimed by the other appellants is that they traced their securities into the hands of Hutton & Company, as of date August 3, 1921, and that such securities were shortly thereafter sold under the direction of the State Court Receiver. The proceeds, however, from the securities claimed by claimants, other than Theis and Lane, were being applied for the purpose of liquidating the indebtedness to Hutton & Company. If there can be any pretention of a tracing of the securities by claimants other than Lane and Theis, the result must be that each and all of the customers of the Bankrupt who owned securities similar to those held at that time by Hutton & Company, and which the Bankrupt should have been holding for them, have to the same extent, as claimants traced and identified their securities, and claimants could in no event claim more than their proper share of the proceeds which remain after the liquidation of Hutton & Company's claim. Expressed differently, they could not in any event claim more than that given by the order of the District Court from

which the appeal is prosecuted, viz., an application of securities owned by the Bankrupt, and to which customers had no right, first toward the liquidation of Hutton & Company's claim. Each of the other securities to contribute pro rata toward the satisfaction of the remainder of Hutton & Company's claim. Each of the customers to be entitled to reclaim from the Trustees the amount which remained as the proceeds from the sale of the security in which he was interested. If there were more than one claimant to such security, such claimant's should in turn pro rate such balance derived from such security. There is neither logic, nor equity, in a claim that the securities owned by these other customers should be taken, and the securities in which claimants were interested should be left intact. Hutton & Company had a right to demand payment of its indebtedness, and to sell the securities for that purpose. If claimants have any right to make any claim, it is only to such balance as may remain after their stock, together with the others, have contributed toward the payment of the indebtedness, for which it all stood pledged.

Some courts have gone to the extent of allowing a recovery on the theory of unjust enrichment. Such claim could not well be made here since claimants position was in no sense different from that of the other creditors of the Bankrupt, who held claims totaling $211,098.27, all of which claims were the result of the wrongful acts of the Bankrupt in appropriating their property. However, the unjust enrichment theory is not recognized in this Circuit.

Spokane County vs. First Nat. Bank, 68 Fed. 979;

Columbia Digger Co. vs. Rector, 215 Fed. 618 (630);

Titlow vs. McCormick, 236 Fed. 209 (214);

U. S. Nat. Bank of Centralia vs. City of Centralia, 240 Fed. 93 (95);

In re Morris Bros., 282 Fed. 670.

For a very full discussion of this unjust enrichment question see in re J. C. Wilson & Co., 252 Fed. 631 (640-642).

The only theory on which any of the claimants other than Lane and Theis can have any relief in this proceeding is the rule as announced in re Toole, 274 Fed. 337, of co-suretyship, or joint-adventurers. The purport of that decision is that all of the customers of the Bankrupt whose securities were in the pledge with Hutton & Company, were joint-adventurers and were co-sureties for the payment of the indebtedness to Hutton & Company, so far as their securities with Hutton & Company were necessary for that purpose; that as such co-sureties their securities should be applied pro rata toward the liquidation of the indebtedness to Hutton & Company for which they stood pledged. Thus it is said:

> "The principle is that where all are equally liable for the payment of a debt, all are bound equally to contribute to that purpose, so that if the stock of A, B and C is lawfully pledged for the payment of the debt of X, the stock of each is under the com-

> mon burden, and, if X sells the stock of A and B and leaves unsold the stock of C the latter must contribute to A and B the *excess they have paid above their share.* But if, on the other hand, the stock of A is lawfully pledged, while that of B and C is unlawfully pledged, there is no obligation on the part of B and C to contribute, for there is no common burden as between A on the one side, and B and C on the other." (Italics ours.)

Finally it is the theory of the claimants that their legal rights and equities are greater because certain of the customers of the Bankrupt, who were interested in certain of the securities held by Hutton & Company, on August 3, 1921, did not make a claim for their securities, or the proceeds. Such a claim, in addition to being most inequitable, can have no support in reason. While respondent, as Trustee, had no higher title to any of these securities than did the Bankrupt, yet anyone who asserts his claim to such securities as against the Trustee, must succeed, if at all, on the strength of his own title and not on the weakness of the title of the Trustee. Further, since the securities in which these other customers were interested were converted without their authority, the customer had one of two remedies. He might, if he so elected, follow the proceeds and reclaim such proceeds, if he was able to successfully trace. If he pursued this course he would have no claim against the Bankrupt for the conversion, since he would have fully satisfied his claim. Or if he so desired, he might claim as against the Bankrupt, for the value of his converted securities. If he adopted this course, he would become a general creditor and

entitled to have his claim satisfied out of any property available for that purpose. Pursuing this course, however, would be a relinquishment to the Bankrupt, or its Trustees, of the proceeds realized from the securities so converted. In other words the Bankrupt would become an involuntary purchaser, the customer being entitled to his demand for the value of the securities, and the title to the securities, or their proceeds vesting in the Bankrupt. In such a case the Bankrupt, or its Trustees, would acquire title through the customer, and not as the result of any ownership as of the date of conversion. Thus, if it should be argued in this case, that since these other customers elected not to claim a return of their securities, or the proceeds such proceeds should be theoretically used to pay Hutton & Company's debt before any application should be made of the securities of any of the claimants for that purpose, there are several quite apparent answers to such contention. In the first place, the title of the Trustee to such securities of the other customers did not exist as of the date the sale was made by Hutton & Company, but has been acquired since, as the result of the election of the customer to claim as a general creditor. Further, to permit such a contention would enable claimants to recover, not on the strength of their own title, or their equities, but on the chance that some other customer similarly situated would forego his right and surrender his title. The legal and equitable right of claimants would not, therefore, be fixed by any certain standard, but would be determined according

to accident or chance. That claimants can not claim except to the extent as shown by the order appealed from, and that their rights can not be enlarged, due to the fact that some other customer of the Bankrupt has failed to make a claim for his securities, or the proceeds realized therefrom, is supported by the only Federal decisions which have passed upon such a question. As to the securities, or their proceeds, which are not reclaimed, they become a part of the general estate for distribution among general creditors.

In re Pierson, 233 Fed. 519 (2nd Cir.), the Court says:

> "The fact that some of the long customers make no specific claim for stock in the surplus can not enlarge the rights of one who does."

In the same case, on rehearing, 238 Fed., 142 it is said:

> "The decision of the Supreme Court in Duel vs. Hollins, 241 U. S. 523, 36 Sup. Ct. 615, 60 L. Ed. 1143, requires us to modify our opinion lately handed down, so as to direct that the court below permit the claimants Van Thyn, Vrieslander, Levy and Quinn to recover their pro rata shares of the respective stocks on hand, *but their shares must be ascertained by including in the calculation the shares of all long customers in the same position, whether they made claim for their shares in the stock on hand or not. That the shares of those who claim should be increased by the circumstance that other long customers made no claim would be inequitable. What would otherwise have gone to those customers should*

go to the general creditors." (*Italics ours.*)

See also:

In re J. C. Wilson & Co., 252 Fed. 631 (639 and 653).

In re Archer, Harvey & Company, 289 Fed. (D. C.) 267, the question received very careful consideration by Judge Rose. The court says:

> "In the case now at this bar, most, if not all, the petitioners owed the bankrupts greater or less sums, and the securities in which they are now trying to assert rights were delivered to the bankrupts or left with them to protect this indebtedness. It does not appear that any of the petitioners gave the bankrupts any express authority to rehypothecate their securities, and any implied power to do so, was, of course, limited to the amount of the bankrupt's advances to them. Any pledging beyond that amount was wrongful, as was any hypothecation at all of the securities owned of the persons who were not indebted to the bankrupts. Under the circumstances of this case, it seems at once just and practically expedient to treat the petitioners whose securities were pledged for a greater amount than that for which the bankrupts had any right to burden them as being as to such excess, but as to that only, in the same class with those whose securities had been hypothecated, although they owed the bankrupts nothing. In re Wilson & Co., Goodman's Claim (D. C.) 252 Fed. 631; in re Bolling, 147 Fed. 786, affirmed in Kean vs. Dickinson, 152 Fed. 1022, 82 C. C. A. 667.
>
> "When the crash came, the bankrupts were short of various kinds of securities; that is to say, the sum of such securities in their box, plus

those pledged by them, was usually less than the total which their books showed belonged to their customers. For example, according to the bankrupts' book, A., B., C., and D. may have been each entitled to 100 shares of X stock. The bankrupts, had none of such in their box, but they did have 200 shares pledged on a loan to the K Bank. A. and B. have each filed petitions alleging themselves to be the owners of 100 shares of that stock, and claiming it. C. and D. have done nothing other than to put in claims as general creditors, without setting up any title to any specific shares, although the time limited by order of the court or so doing has long since expired. The Trustee contends that A. and B. are entitled to but one-quarter each of the stock which in any sense survived Bankruptcy; that is to say, 50 shares each, of rather to any surviving equity there may be therein after the payment of the sums due the pledgee. A. and B. answer that if, for the purpose of this case, it be assumed that they each could claim but 50 shares held by the pledgee, they are at all events clearly entitled to have any shares belonging to the bankrupts, or which, although not owned by the bankrupts, were rightfully pledged by the latter and in the hands of the pledgee, first applied to the payment of the debt before their stock can be called upon for contribution. In re Hollins & Co., 232 Fed. 124, 146 C. C. A. 316. If no one other than the bankrupts claim the 100 shares, which possibly or probably might have been claimed by C. and D., either those shares remain the Bankrupt's property or were rightfully pledged by them, and must be first applied to the extinguishment of the bankrupt's debt to the pledgee. As the accounts actually work out in this case, petitioners, who are in the situation of A. and B., are content to be dealt with upon the theory last stated without raising the question whether they are or are not entitled to assert that, there being 200 shares un-

claimed by others than themselves, and that being precisely the amount due them, they are entitled each to his 100 shares, or rather to the equity therein."

Proceeding further and after referring to in re Pearson, Supra., and in re J. C. Wilson & Co., Supra., the court says:

"The practical importance of having a fixed and uniform rule in these cases is great. There is more frequent occasion to apply it in New York than anywhere else. There is, therefore, more than the ordinary reason why a District Court should accept the view taken by the Circuit Court of Appeals of another Circuit. Besides, much can be said for the essential fairness of the practice there prevailing." (In New York, as the rule is announced in re Pearson and in re J. C. Wilson & Co.) "Under it, each claimant gets all to which he is entitled. That something which might otherwise be taken for the exclusive use of a rival claimant actually goes to all the creditors is really to the advantage of the petitioner, in that it increases the fund upon which he will be entitled to go for a dividend for so much of his claim as is unsecured. It is true that he has the right, before his securities can be called upon to contribute to the debt for which they were pledged, to require the application to that pledge of everything which belonged to the bankrupt and which was pledged with the claimants. But is there not more of theory than substance in the assumption that the unclaimed property must be treated as if it had been the Bankrupt's at bankruptcy merely because another customer in like class with petitioner does not, after bankruptcy, claim what such other was entitled to? There would seem to be nothing to be entitled to? There would seem to be nothing

to recommend it, except a certain formal logic, which it has or seems to have. Moreover, is there any reason why the courts should put a premium upon filing preferential claims? When made, they must be respected; but, as a rule, are not the superior rights so asserted almost always the result of accident or chance? In the long run, would not as high a degree of equity be worked out, if all the customers of the bankrupt brokers shared equally in their assets, and that, too, with infinitely less of trouble, delay, and expense.

In stating the accounts in this case, each of the petitioners who has a claim for a portion of any security or for the surplus remaining after the payment of the debt for which it in common, with others has been pledged, must be treated as the owner of that proportion; but he is not to benefit by the fact that other persons, having equal rights with him to share in that security, have made no claim therefor. The proposition of the security or the equity therein to which such others are entitled, are to go to the bankruptcy trustee for the benefit of the general creditors, not because at bankruptcy they were the property of the bankrupt, but because, after the bankruptcy, those to whom they belonged preferred to allow them to become a part of the property to be equally distributed among all the creditors." (Italics ours.)

The order made by the District Court, from which this appeal is prosecuted, is squarely in harmony with in re Archer, Harvey and Co., Supra. In every respect such order so made is consistent with that decision, likewise it is entirely consistent with in re Toole, in re Pearson, in re Toole and in re J. C. Wilson & Co. The adoption of any other rule could not be sus-

tained on any legal ground and would be most inequitable.

CLAIMANT'S BRIEF

Some reliance is placed by claimants, due to the fact, as they claim, that on January 23, 1923, an order was made by the Referee directing all having claims to the Hutton & Company fund, to appear and assert their claim. (Claimant's Brief 6.) Respondent disputes that there was any proceeding taken before the Referee, which would in any respect enlarge claimant's right, or restrict respondent's right, or that any such attempt was made. Further at all hearings, involving the fund in controversy, the general creditors through the Trustee in Bankruptcy was before the referee asserting their right to this fund. No matter what proceedings may have been taken before the Referee, it is manifest that they could not be of a nature that would transfer to the claimants here property belonging to other customers of the Bankrupt. Claimants were not asserting ownership in the fund remaining with Hutton & Company, but were asserting ownership only to certain specific securities which they claimed were, on August 3, 1921, held by Hutton & Company. Any notice given, such as suggested by claimants, could only have the effect of adjudicating the right as to such specific securities in which claimants were interested, and any proceeds realized therefrom. It would scarcely be claimed that it would have the effect of adjudicating title in claimant's to cer-

tain securities, or their proceeds, to which they had never, in fact, made claim.

At page 10 and at other places in their brief, claimants urge that their securities were wrongfully pledged with Hutton & Company. If this is true, then it is likewise true as to the other customers of the Bankrupt, whose securities were with Hutton & Company on August 3, 1921. However, claimant's statement is not accurate. The securities were rightfully in pledge. The Bankrupt, was guilty of a breach of contract, in that it was its duty upon payment being made for the securities in pledge, or upon the Bankrupt converting other securities of the customer, sufficient to turn the debit balance of such customer into a credit balance, to withdraw the securities of such customer from the pledge. All of the customers of the Bankrupt, whose securities were in the hands of Hutton & Company, were similarly situated. A similar breach of contract as to each of them existed, since any debit balance due from them to the Bankrupt had been changed into a credit balance, either by payment, or by conversion of other securities. As to none of the claimants, however, was there a wrongful pledge. At most there was a commission of a wrong through the conversion of other securities, and a failure to perform its contract and in not withdrawing the securities rightfully pledged from Hutton & Company.

The decision in Skiff vs. Stoddard, 63 Conn. 216, and in re Mills, 110 N. Y. Supp. 314, have to do with

a wrongful appropriation of securities, under circumstances which amounted to a larceny. Thus in re Mills the securities were left with the broker for safekeeping. She had no trade pending, and owed the brokers no money, and they never had any authority either express or implied to use her securities. The Court says: "She owed them nothing, and they had no more right to pledge her stock as security for the loan, than they would have had to have taken money out of her pocket against her will. It was larceny of the stock and nothing else." In re Mills follows the decision of the same court in Tompkins vs. Morton Trust Company, 86 N. Y. Supp., 520, which last mentioned case is referred to by the second circuit in the decision in re McIntyre, 181 Fed. 955, where in considering Pippey's appeal, the court held that Pippey had a right to reclaim his stock, which had been traced and was still in existence, and in the hands of the trustee, without being required to contribute in favor of others whose securities had been sold to satisfy the pledge. The theory of the decision in re McIntyre was that when the broker pledged Pippey's stock he was committing a larceny, and this feature is very carefully examined and considered in re J. C. Wilson & Co., 252 Fed. 631, and the decision very carefully interpreted as to the Pippey doctrine at pages 636-640, where it is pointed out that the whole question turned upon whether the securities had been *originally* pledged by the broker rightfully, or under circumstances which amounted in effect to larceny. If originally pledged rightfully, he could not demand a

surrender of his securities which survived, without contributing in favor of those whose securities did not survive, and whose securities were used to pay the indebtedness for which all stood as collateral "the excess they have paid above their share," but if the securities were pledged under conditions which, in effect, amounted to larceny, he could not be required to contribute since there was no co-suretyship or co-adventure, as discussed in re Toole, 274, Fed. 337.

Claimants have discussed and quoted from in re Ennis at pages 13 to 17 of their Brief. In re Ennis and all other Federal decisions, dealing with the question there discussed turned upon the question as to whether there was a pledge by the Bankrupt under conditions which amounted to a larceny. Thus it is said:

> "When a broker pledges as collateral to a loan at a bank, securities left with him for safe keeping or for sale, he is a wrongdoer from the outset, and, while the bank may have the right to hold the securities, the claim of the owner upon the satisfaction of the Bank's demand is of the highest equity."

The quotation above from in re Ennis is entirely in harmony with in re McIntyre, in re J. C. Wilson and Co., and deals with a condition that is not involved in the slightest in this case. The securities of claimants were rightfully pledged. At most there was a wrongful action in permitting them to remain in the pledge, if the indebtedness due the Bankrupt had been paid. There was no question of a larceny of the se-

curities, which as stated in re Ennis, in re McIntyre and in re J. C. Wilson & Co. and also in re Mills represent the highest character of equity.

Claimants again at pages 20 and 21 of their brief refer to the alleged order made by the Referee attempting to bar other customers interested in the fund. We are in doubt as to just what claimant's contention is. Surely they can not contend that any such order vested the ownership that existed in other customers in themselves. However that may be, the order which was made by the Referee, is the one which was reversed by the District Court, and in that proceeding the general creditors were before the Referee through the Trustee in Bankruptcy protesting against the dissipation of the fund, which was in the Trustees' hands, and asserting ownership thereto as against claimants. In this situation, the language used by the court in re J. C. Wilson & Co., 252 Fed. 631 (639) is pertinent, in referring to in re McIntyre:

> "As, however, those similarly situated with Pippey did not appeal, the Circuit Court of Appeals had no grievance before it on the part of those claimants. The case was not like Matter of Pierson, 232 Fed. 519, 147 C. C. A. 405 and 238 Fed. 142, 151, C. C. A. 218, *where the general creditors via the trustee were before the court,* and the court held that the mere fact that certain customers (like Cochran) had not made a claim, could not serve to increase the shares of those who did claim. (Under Duel vs. Hollins, 241 U. S., 523, 36 Sup. Ct. 615, 60 L. Ed. 1143), and to decrease the fund available for general creditors." (Italics ours.)

Claimants, in their brief (p. 31), say:

> "This being true must we be forced to deliver to the trustee, who, as far as these proceedings is concerned, stands garbed as the wrongdoer, Whitehouse, the lion's share of our property, * * *."

This is a rather remarkable statement. It has been respondent's understanding that he owed a duty to the general creditors to protect the estate, so far as possible, and not to permit claims such as these to be asserted, where there was not the proper legal or equitable foundation therefor. It does not seem to respondent that he is a wrongdoer in opposing, practically all of the estate being diverted to claimants whose equities are not superior to that of practically all other creditors of the Bankrupt. It has seemed to respondent that, these other customers of the Bankrupt, whose securities were held by Hutton & Company, should be entitled to some consideration, and they can receive no consideration except as general creditors. It has not seemed to the respondent that any equitable principle would permit the taking of such other customers' property, and bestowing it upon claimants, and especially when such a course would result in depriving them of the dividends, which they are rightfully entitled to claim as general creditors.

That claimants' contention, as to the position occupied by the Trustee, is unsound, appears clearly from the 1910 amendment to the Bankruptcy Act. This amendment to Section 47 is as follows:

> "Such Trustees, as to all property in the custody, or coming into the custody of the Bankruptcy Court shall be deemed vested with all the rights, remedies and powers of a creditor holding a lien by legal or equitable proceeding thereon; * * *."

This court, in construing said Section 47, in Pacific State Bank vs. Coats, 205 Fed. 618, has said:

> "The Trustee no longer stands in the shoes merely of the Bankrupt * * *."

We submit that the order of the District Court, from which the appeal is prosecuted, is as favorable to claimants, as the law, and the principles of equity, will permit, and that the judgment of the District Court should in all respects be affirmed.

Respectfully submitted,

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